

**MODERNIZING FINANCIAL
MANAGEMENT FOR
HUNGARIAN LOCAL
GOVERNMENTS**

**SECOND YEAR SEMINAR:
SEPTEMBER 24-25, 1997**

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MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS

SECOND YEAR SEMINAR: SEPTEMBER 24-25, 1997

This report briefly describes the September seminar on Modernizing Financial Management for Hungarian Local Governments. The program aims at training Hungarian local government finance officers to improve budgeting and financial management within their cities. The September seminar was the third seminar of the second year program, which extends from May 1997 to March 1998.

The two day seminar was held on September 24-25, 1997 at Hotel Rubin in Budapest. The agenda, list of participants, and course material handed out to participants are included in Annex A. Seventeen local governments attended the September seminar, some from large cities like Debrecen and Székesfehérvár, but the majority from smaller towns. Table 1 shows the list of local governments who have attended the seminar so far.

SEPTEMBER 24, 1997

The program started with an evaluation of the homework assigned to the participants at the last seminar held in June. Székesfehérvár turned in a very good assignment on fiscal indicators, and Nagykőrös, Székesfehérvár, and Gödöllő submitted the sector analysis assignment.

Training Session I: Revenue Alternatives

The first training session comprised of a presentation by Mr. Philip Rosenberg (consultant to the Urban Institute (UI)) on revenue alternatives, in which he emphasized that one of the core goals of local governments should be to assure funds and other conditions for the operation of services. An important means to achieve this is to levy fees for services provided by the city.

Mr. Rosenberg then went on to describe the nature of user fees, their use, and the factors that should be taken into consideration when using them. His presentation had the following outline:

- Characteristics of fees
- Contrasting characteristics of taxes and user fees
- Factors to be considered in charging fees
- Pricing policies
- Considerations
- Types of rates

After Mr. Rosenberg's presentation the participants raised the following questions:

Anomalies of Motor Way Fees. (1) Since these fees did not exist in the previous regime, the public is generally reluctant to pay them. (2) The price of petrol/gas already includes different types of charges and fees related to road maintenance. Therefore drivers are not willing to pay additional money to use the motor way. (3) The system of motor way fees is very new and unusual to Hungarians. Generally speaking the public is not really willing to pay for saving half an hour in time or kilometers traveled, if the fee is too expensive. (4) Sometimes the price of the motor way fee is so high that drivers would rather take the sub-roads via villages, thus posing a tremendous burden on the citizens, roads and environment of smaller communities.

The topic of motor way fees was of special interest to the city of Gödöllő, since they recently introduced a motor way fee system. As a result of this fee most of the traffic now flows through neighboring small villages. The participant from Gödöllő therefore felt that it should be the task of economists to predict and evaluate the efficiency of such systems. Mr. Hegedüs (Metropolitan Research Institute (MRI)) replied that this is a complicated issue since it is difficult to predict the habits of drivers/customers. Even if there is a study aimed at gathering information on the willingness to pay the fee among citizens, answers given at the time of questioning may not be equivalent to later behavior.

Alternatives to Development Impact Fees. The issue discussed here was the comparison between development impact fees and development impact taxes, and whether the introduction and use of development impact fees in case of constructing municipal public utilities is better than levying taxes. The core question focused on the following problem: if the local government wants to implement an investment in public utilities (constructing new roads, road maintenance, water-plant reconstruction, etc.), where there are easily identifiable beneficiaries of the investment, two means of financing should be used—either the local government levies development impact fee on the beneficiaries, or taxes on the establishment so that everybody pays the same, irrespective of whether they are direct beneficiaries or not.

Dilemma of Creating Parking Association. This discussion was on negotiating a parking association in Budapest whereby the citizens of the member Budapest districts can park their cars in co-operating districts for a given fee. This has only partially solved the parking problem of Budapest.

Public Services and Market Competition. This issue was raised based on Mr. Rosenberg's statement that the price/fee of public services normally drops as soon as there are several companies providing the same service. One of the participants asked how this actually works in practice. Mr. Rosenberg replied that this type of competition can only work if one of the service providers can offer the service for a far cheaper price/fee, so that it is still beneficial to the customer to pay for the service. For example, the fee paid by customers to a gas provider should be low enough so that customers are willing to pay it. It should also cover the fees paid by the gas provider to the company which constructed the gas network for



the transmission of gas.

Meeting to Establish a Municipal Finance Officers Association in Hungary

During lunch, some of the local government finance officers had their first meeting with the intention of establishing a Government Finance Officers Association in Hungary. Approximately 8 finance officers participated in this initial meeting, and set an agenda for themselves to: (1) assess the interest of other local government finance officers in such an association, and (2) set a date for a follow up meeting, and establish a business plan for the organization.

Exercise on Revenue Alternatives

After lunch Mr. Hegedüs and Mr. Rosenberg conducted a case study on user fees titled “The Price is Right.” The case was about a city situated next to a river, and the recent takeover by the city of ownership and management of the water company. The water treatment plant is not operating properly—there are leaks, the water pressure is sometimes inadequate during the day, etc. Unfortunately, the City's financial situation is not favorable, the unemployment rate is high and the infrastructure is poor. The Mayor has to search for revenue sources to enable his City to survive, and is considering several fee options. Seminar participants were divided into four groups to analyze the case and suggest recommendations for the Mayor.

The analysis and recommendation of the four groups was as follows:

- ! *Group 1:* (1) hold public hearings, so as to involve citizens in finding a solution to the problem, (2) the Mayor should establish a management unit, with the aim of attracting external capital and selling certain properties, and (3) introduce a water fee.
- ! *Group 2:* (1) gradual introduction of a water fee, maybe in two-three steps. (2) the water fee should be a flat fee. Note: the origin of the problem is the general development of the city. It is therefore not likely that one individual step will really move the trend in the desired direction.
- ! *Group 3:* (1) introduce a water fee, but with a price differentiation for household and industrial consumers, (2) start by installing water meters by house blocks, (3) the city should start issuing applications for tenders, and (4) provide compensation for families in socially unfavorable conditions.
- ! *Group 4:* (1) collect information and data before the decision is made—what central sources are available? who operates the waterworks? what are the characteristics of the consumers? Expectations: Decrease in water consumption (less water is wasted).

Sectoral Analysis of Revenue Alternatives



Mrs. Kürthy, head of the finance department of Püspökladány made a presentation on revenue alternatives in the education sector. Püspökladány has started budget reform in this sector, and as part of the sectoral analysis the city collected and analyzed the revenues and expenditures related to education. There are two main revenue sources: central subsidies (80-95 percent) and own revenues (20-5 percent). As the central (normative) subsidies tend to decline, the municipality has to think about how to increase its own resources. The operating costs in the education sector are very high, while the possibilities to create own resources are very limited. Mrs. Kürthy also mentioned, that the introduction of the local treasury has significantly increased the interest revenues of the city, and this is an additional revenue for some of the sectors (education, social sector). Mrs. Kürthy completed her presentation by describing the revenue alternatives for each type of educational institutions (kindergartens, primary schools, secondary schools, etc.).

Exercise on Revenue Alternatives in the Sanitation Department

Due to lack of time, Mr. Rosenberg was unable to conduct this exercise. He requested the participants to analyze the exercise in the evening and think of the solution. The exercise was based on a city that is considering establishing user charges for sanitation services. The city would like to charge a different fee to different customers, and the participants had to determine this differentiated price by relating the user charge to the cost of the service.

Mr. Rosenberg commented, that If the garbage fee system is transparent, fair and payable, it has a positive effect on citizens intentions to pay the fee. Differentiated garbage fees are more fair. However, there are cases when the decision about different types of fees is not easy to reach. Citizens may not be willing to pay a flat fee in block houses, where a given number of trash containers are available for the given number of flats (households) in the block. This situation may cause disputes, since families with four children generate more trash than an elderly couple.

Training Session II: General Forecasting Techniques

Following Mr. Rosenberg's brief discussion, Mr. Róbert Kovács (MRI) made a presentation on revenue and expenditure forecasting. His presentation was based on the following outline:

- Forecasting Functions
- Types of Forecasting Models
- Information Basis for Forecasting - External Information
- Information Basis for Forecasting - Internal Information
- Methodological Problems of Information Handling

Mr. Kovács described the Credit Local de France (CLF) model of forecasting, and stressed the need for a reliable data base for the purpose of forecasting. Since transition economies sometimes experience drastic/severe economic changes from year to year,

accurate forecasting requires trend analysis and the use of both current and past data. Mr. Kovács also pointed out that in Hungary there are so many discrepancies in the data and unpredictable events, that trend analysis sometimes proves worthless in forecasting. Despite this, forecasting is still useful in drawing conclusions and making long-term decisions.

Mr. Kovács also discussed the following:

- The objective of forecasting
- The extent to which the categories are exact
- To what extent does this affect the result

SEPTEMBER 25, THURSDAY

The second day of the seminar started with an exercise on forecasting. Before the start of the exercise, Mr. Kovács briefly reviewed his presentation on forecasting from the previous day.

Forecasting Exercise

The forecasting exercise required participants to forecast the economic condition of a hypothetical city for three years based on budgetary data. The city is in the process of considering important investments. Participants had to suggest the level of investment appropriate for the local budget, the timing of the investment, and whether it is preferable for the city to take a loan. The analysis by the three groups was as briefly follows:

- ! *Group 1:* The local government is just about to go bankrupt, mainly due to loans taken to finance current operations. This group emphasized the drastic jump in the cost of education. They proposed an extended institutional reform; rationalization; and involving external experts.
- ! *Group 2:* They agreed with the analysis of the previous group and added the following proposals: stir up the local business sector activities; re-schedule loans; request application for tenders; and search for investors (external and internal).
- ! *Group 3:* This group agreed with the opinion of the first two groups, and had nothing further to add.

Training Session III: Performance Measurements

Ms. Ritu Nayyar-Stone (UI) started her presentation by defining the term 'Performance Measurements' and stressing the importance of these measures in local governments' self-evaluation and evaluation by the citizens. She stated that performance measurement relates to all functions of the management cycle and all levels of the department, and has the following



benefits: it (1) strengthens accountability, (2) improves customer service, (3) empowers employees, and (4) improves program performance. Ms. Nayyar-Stone's presentation had the following outline:

- Introduction: Managing for Results
- How to Develop Performance Measurements
- Data Collection
- Using Performance Measurements
- Implementation on a Government Wide Basis

Ms. Nayyar-Stone's presentation was followed by a speech by the guest speaker Mrs. Imre Darázs from the Ministry of Interior, Department of Local Governments.

Guest Speaker

Mrs. Darázs discussed changes in the 1998 central budget that impact local governments. Although municipal revenues are expected to increase in 1998, they will increase to a lesser extent relative to GDP. The normative support to local governments will change, as well as the emphasis on task-oriented allocation of resources. The criteria for change will be to equalize regional differences. It will also aim at increasing salary categories for those working in government administration. The volume of municipal investment will also increase (for the first time). The Regional Development Councils will have a budget of 4 billion Ft., which will probably be spent on infrastructure improvements.

Mrs. Darázs's presentation was followed by several questions: (1) What percent of the cost of education is covered by normative support? Answer: by law it should be 80 percent. (2) What are the allocation criteria of the 4 billion Ft. support to the Regional Development Council? Answer: there are three criteria—taxes, number of citizens, and number of municipalities. (3) Different grant applications for the same sector are not coordinated and synchronized at the central level, which causes local governments to miss opportunities for central funding. Reply: this critique is true. However, the government is aware of this flaw and working on finding a solution to the problem.

Performance Measurement Case Study and Group Presentation

All participants had to specify performance measures in four strategic priority areas of a hypothetical city, Nagyvaros—customer- focused government; neighborhood vitality; family, youth and community values; and financial health and economic development—and also develop performance measures in one of the following departments of their choice—education, city management and social services.

The responses of the participants to the four priority areas were as follows:

- ! *Customer-Focused Government:* quick answers to letters, more frequent public hearings, surveys on the satisfaction of citizens. Ms. Nayyar-Stone suggested the following additional indicators: increase the coverage of citizen services from X to Y percent, increase the percent of citizen guides and budget summaries, decrease the response time to citizen complaints.
- ! *Neighborhood Vitality:* to speed up and extend the flow of information, citizens forums. Ms. Nayyar-Stone suggested the following additional indicators: increase the percent of volunteer clean up groups for the city, increase the number of housing units that are safe and sanitary, decrease the percent of neighborhood/juvenile crime through a job skills program.
- ! *Family, Youth, and Community Values:* decrease the number of accidents involving children, organization of recreational program, DADA (drugs, alcohol, cigarettes, AIDS) program. Ms. Nayyar-Stone suggested the following indicators: Increase the percent of children's playgrounds in the city by 10 percent, increase the percent of services that are accessible to the elderly - e.g. help buy groceries, escort service etc., increase the percent of streets that are adequately lighted in the city.
- ! *Financial Health and Economic Development:* minimize migration/number of families in unfavorable situations, increase the amount of house construction, promote public jobs. Additional indicators suggested by Ms. Nayyar-Stone: increase the percent of cash reserves of the city by 5 percent, decrease the use of debt to cover operating expenses of the city by 5 percent, improve the process of giving business licenses/permits to increase investment in the city.

Homework Assignment

Participants were given two assignments to be completed prior to the November seminar: (1) an assignment on forecasting, and (2) an assignment that required participants to write goals and objectives and performance indicators for a sub-program of their choice for their community.



Table 1

List of Cities Participating in the Second Year (1997-1998) Seminars on Modernizing Financial Management for Hungarian Local Governments

No.	Cities	Population	May 14-15, 1997	June 18-19, 1997	September 24-25, 1997
.	Budapest District VI	23,246	✓		✓
.	Csongrád	19,112	✓	✓	✓
.	Debrecen	210,143	✓	✓	✓
.	Eger	61,400	✓		✓
.	Gödöllő	29,761	✓	✓	✓
.	Hajdúszoboszló	23,387	✓	✓	✓
.	Hódmezővásárhely	49,901	✓		✓
.	Karcag	22,637	✓		
.	Kazincbarcika	34,759	✓	✓	✓
.	Kecskemét	105,058	✓	✓	✓
.	Nagykanizsa	53,353	✓	✓	✓
.	Nagykőrös	26,646		✓	✓
.	Orosháza	34,600		✓	✓
.	Püspökladány	17,000	✓	✓	✓
.	Szegvár	5,285	✓	✓	✓
.	Székesfehérvár	107,181	✓	✓	✓
.	Szentes	33,000	✓	✓	✓
.	Szolnok	81,500	✓	✓	✓

ANNEX A

MODERNIZING FINANCIAL MANAGEMENT FOR HUNGARIAN LOCAL GOVERNMENTS